



RULE
ADOPTION
NOTICE

RAN-01-40
October 2, 2001

TO: All PCX Members and Member Organizations

FROM: Department of Regulatory Policy

**SUBJECT: Auto-Ex Incentive Program for Market Makers
(File No. SR-PCX-2001-05)**

On September 25, 2001, the Securities and Exchange Commission approved, on a nine month pilot basis, the PCX's rule proposal to modify the Automatic Execution System ("Auto-Ex") so that it will assign inbound Auto-Ex orders to logged-on Market Makers according to their percentage of in-person agency contracts¹ traded in an issue compared with all of the Market Maker in-person agency contracts traded during the review period. The review period will be determined by the Options Floor Trading Committee ("OFTC") and may be for any period of time not in excess of two weeks. The percentage distribution determined for a review period will be effective for the succeeding review period. The OFTC has determined that the review period will be two weeks. It is planned that the first review period will commence October 8, 2001, and the new assignment process will become operational two weeks thereafter on October 22, 2001. This method replaces the current method of assigning inbound orders on Auto-Ex.

Following is the text of the rule change that the SEC approved on a pilot basis. Questions regarding this bulletin may be directed to Cindy Sink at (415) 393-7926.

EXHIBIT A

Text of the Rule Change²

Rule 6.87(a) – (j) – No change.

6.87(k) Allocation of Auto-Ex Trades to Individual Market Makers. The OFTC will determine the manner in which orders entered through the Auto-Ex system will be assigned to

¹ Agency contracts are those contracts that are represented by an agent and do not include contracts traded between Market Makers in the trading crowd.

² New text is underscored. Deleted text is in brackets.

individual Market Makers for execution, on an issue-by-issue basis, [subject to the following restrictions:] as follows:

[(1) Each Market Maker who is participating on the Auto-Ex system will be to execute a maximum of ten option contracts per Auto-Ex trade, except that:]

[(A) The OFTC may permit individual Market Makers and Lead Market Makers (“LMMs”) to be allocated a number of contracts greater than ten and no more than fifty, but may do so only upon the request of the individual Market Maker or LMM.]

[(B) In accordance with the provision on LMMs’ guaranteed participation in Rule 6.82(d)(2), the LMM in an issue will be required either (i) to participate in every other trade executed on Auto-Ex in that issue or (ii) to participate in a percentage of every trade consistent with the amount of the LMM’s amount of guaranteed participation.]

[(C) The OFTC may require Market Makers or an LMM who is participating on Auto-Ex in a particular option issue to execute a number of contracts greater than ten, but before doing so, the OFTC must take into account whether doing so would place a Market Maker at undue risk based on that Market Maker’s capitalization.]

[(2) The OFTC will ordinarily seek to assure that each Market Maker participating on Auto-Ex in a particular option issue will be assigned up to the same maximum number of option contracts per Auto-Ex trade. The OFTC may permit exceptions to this procedure only in unusual situations where the OFTC finds good cause for permitting differences in the maximum number of contracts executed by individual Market Makers.]

Auto-Ex Incentive Program

(1) Auto-Ex orders are assigned to Market Makers who are logged-on Auto-Ex according to the percentage of their in-person agency contracts traded in that issue (excluding Auto-Ex contracts traded) compared to all of the Market Maker in-person agency contracts traded (excluding Auto-Ex contracts) during the review period. The review period will be determined by the Options Floor Trading Committee (“OFTC”) and may be for any period of time not in excess of two weeks. The percentage distribution determined for a review period will be effective for the succeeding review period.

(A) *Participation Percentage Calculation.* Each Auto-Ex order in an issue will be allocated to Market Makers on Auto-Ex on a rotating basis. On each rotation (subject to the exceptions described below) each participating Market Maker logged onto Auto-Ex will be assigned the number of Auto-Ex contracts that reflects the percentage of agency contracts that the Market Maker traded in-person in that issue during the review period. A participation percentage will be calculated for each Market Maker for each issue that the Market Maker trades.

For this purpose, all transactions on behalf of the same LMM will be aggregated into a single percentage for the LMM.

(B) *Assignment of Contracts.* Once a Market Maker has logged onto Auto-Ex, the Market Maker will be assigned contracts during the Auto-Ex rotation until that Market Maker's participation percentage has been met. This may mean that multiple orders (or an order and a part of the succeeding order) will be assigned to the same Market Maker during the rotation.

(C) *Joint Accounts.* A joint account participant may substitute on the Auto-Ex wheel for another participant who is registered to trade the same joint account and may receive the same participation percentage that has been established for the participant for which the replacement is substituting, provided that the following conditions are met:

- (i) the substitute must notify the OBO of the substitution;
- (ii) the substitute must log on to the same option issues that the original trader was logged-on to; and
- (iii) the agency trades of the substitute will count toward the calculation of the participation percentage of the original participant for the subsequent review period.

(D) *Minimum Participation.* The Exchange will determine the number of contracts that make up one percent of the rotation. Market Makers logged onto Auto-Ex in an issue, regardless of their participation percentage, will be entitled to at least one percent of the rotation on every rotation.

(E) *Rotation.* Generally, one rotation consists of the number of contracts replicating the cumulative percentage of all Market Makers logged onto Auto-Ex who have a participation percentage plus one percentage for each Market Maker that does not have a specific participation percentage.

(F) *Maximum assignment.* The maximum number of contracts that a Market Maker may be consecutively assigned at any one time during a rotation will be variable and may be different for different issues or the same for all issues. Because the maximum number of contracts permitted may be smaller than the number of contracts to which a particular Market Maker is entitled during one rotation, that Market Maker will receive more than one turn during one rotation.